

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /  
Or Sponsoring Organization Is Missing

5. Market Analysis/Urban Economics/Real Estate  
Process

a. "Contemporary Real Estate Market  
Analysis", April 26-29, 1978

## CONTEMPORARY REAL ESTATE MARKET ANALYSIS

University of Wisconsin, Real Estate Department  
April 26-29, 1978

Instructor: Professor James A. Graaskamp  
University of Wisconsin School of Business

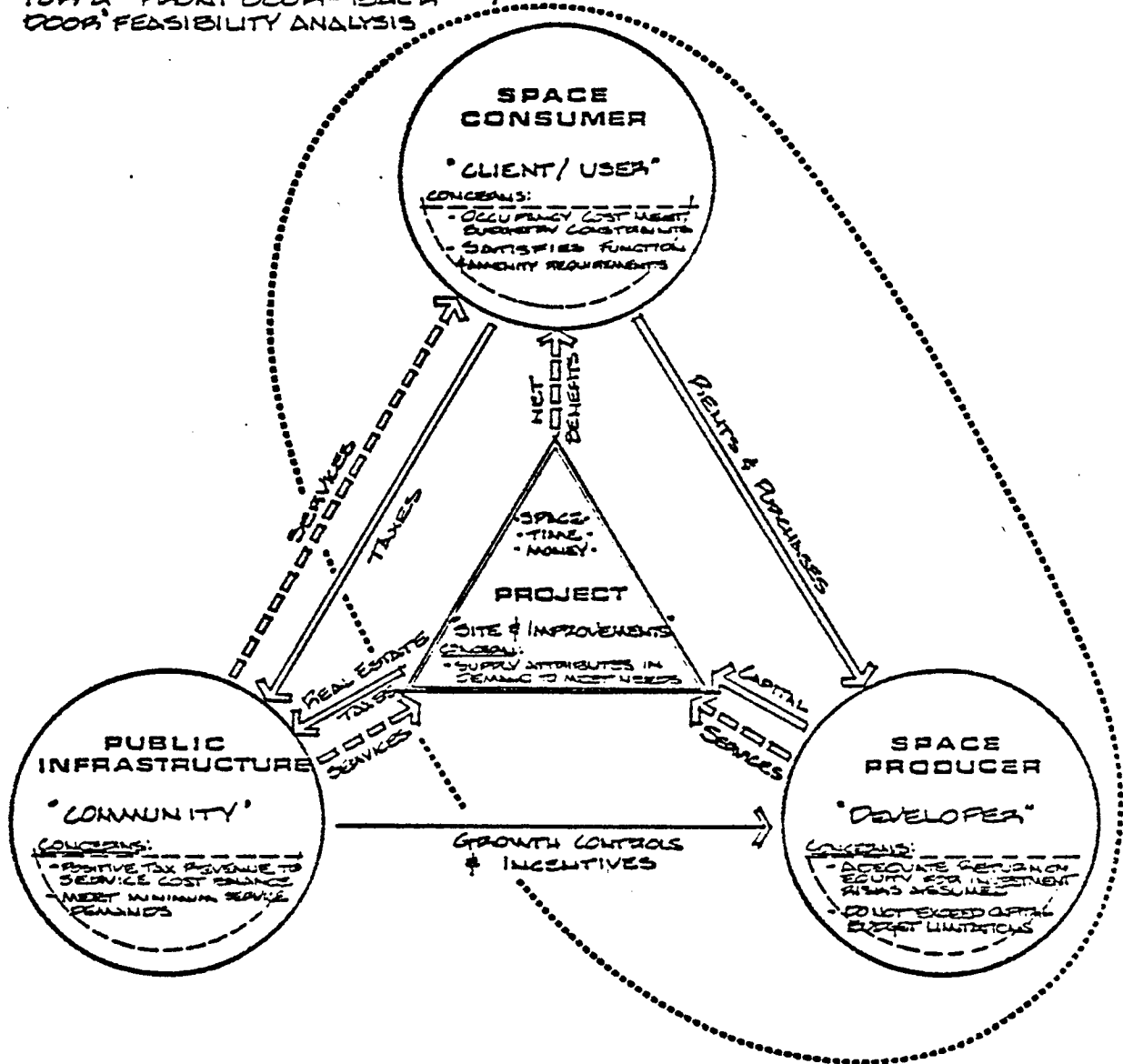
FIRST MORNING  
9:00 A.M.-10:15 A.M.

### I. Basic Concepts and Definitions

- A. Real estate is a tangible product - defined as artificially delineated space with a fourth dimension of time referenced to a fixed point on the face of the earth.
1. Real estate is a space-time unit, room per night, apartment per month, square foot per year, tennis court hours, or a condominium for two weeks in January at a ski slope.
  2. To the space-time abstraction can be added special attributes to house some form of activity.
  3. Improvements from survey market to city layouts to structures define space.
  4. Legal contracts and precedents define time.
  5. Rights of use are defined by public values, court opinions.
  6. Private rights to use are those which remain after the public has exercised its rights to control, to tax, or to condemn.
- B. A real estate project is cash cycle business enterprise which combines a space-time product with certain types of management services to meet the needs of a specific user. It is the process of converting space-time needs to money-time dimensions in a cash economy.
1. A real estate business is any business which provides expertise necessary to relate space-time need to money-time requirements and includes architects, brokers, city planners, mortgage bankers, and all other special skills.
  2. The true profit centers in real estate are in the delivery of services and cash capital. Money is an energy transfer system.
  3. Equity ownership is the degree to which one enterprise controls or diverts cash from another real estate enterprise.
  4. Public has direct ownership to the degree real estate taxes take a percentage of tenant income in excess of service cost.
  5. Consumer must view space as a total consumption system involving direct cost, surface cost, transportation cost and negative income of risk.
  6. The best real estate project is the one which has the lowest net present value of cost as the sum of cost to the consumer production sector and public sector.

EXHIBIT I

DATA INPUT CONCENTRATION FOR A "FRONT DOOR - BACK DOOR" FEASIBILITY ANALYSIS



THE REAL ESTATE DEVELOPMENT SYSTEM

- C. The real estate process is the dynamic interaction of three groups, space users (consumers), space producers, and the various public agencies (infrastructures) which provide services and capital to support the consumer needs. (See Exhibit 1)
  - 1. Each of these three decision groups represent an enterprise, an organized undertaking. All are cash cycle enterprises constrained by a need for cash solvency, both short and long term.
  - 2. A desirable real estate solution occurs when the process permits maximum satisfaction to the consumer at a price that he can afford within the environmental limits of land while permitting the consumer, producer, and the government cash cycle to achieve solvency - cash break even at a minimum, after full payment for services rendered.
  - 3. Solvency of the total process, not value, is the critical issue.
  - 4. Land is an environmental constraint and not a profit center.
  - 5. Land provides access to a real estate business opportunity and is not the opportunity itself. Real estate business wants to control land to create a captive market for services.
  
- D. Land is the point where demand and supply forces find cash solvency. Location is a manufactured attribute. Site attributes are exploited to create location by analyzing:
  - 1. Static attributes.
  - 2. Legal-political attributes.
  - 3. Linkage attributes.
  - 4. Dynamic attributes.
  
- E. Recognition of the fact that profit maximization must be limited by concerns for physical environment and community priorities for land use has resulted in redefinition of the most basic concept in appraisal; i.e. highest and best use, in the authorized terminology handbook sponsored by the American Institute of Real Estate Appraisers and the Society of Real Estate Appraisers. Compare the 1971 definition with that for 1975:

Highest and best use concept-

"A valuation concept that can be applied to either the land or improvements. It normally is used to mean that use of a parcel of land (without regard to any improvements upon it) that will maximize the owner's wealth by being the most profitable use of the land. The concept of highest and best use can also be applied to a property which has some improvements upon it that have a remaining economic life. In this context, highest and best use can refer to that use of the existing improvements which is most profitable to the owner. It is possible to have two different highest and best uses for the same property: one for the land ignoring the improvements; and another that recognizes the presence of the improvements.:

p. 57, Real Estate Appraisal Principles and Terminology, Second Edition, Society of Real Estate Appraisers 1971.

"Highest and Best Use: That reasonable and probable use that will support the highest present value, as defined, as of the effective date of the appraisal. Alternatively, that use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately supported, financially feasible, and which results in highest land value. The definition immediately above applies specifically to the highest and best use of land. It is to be recognized that in cases where a site has existing improvements on it, the highest and best use may very well be determined to be different from the existing use. The existing use will continue, however, unless and until land value in its highest and best use exceeds the total value of the property in its existing use. Implied within these definitions is recognition of the contribution of that specific use to community environment or to community development goals in addition to wealth maximization of individual property owners. Also implied is that the determination of highest and best use results from the appraisers judgement and analytical skill, i.e., that the determined from analysis represents an opinion, not a fact to be found. In appraisal practice, the concept of highest and best use represents the premise upon which value is based. In the context of most probable selling price (market value) another appropriate term to reflect highest and best use would be most probable use. In the context of investment value an alternative term would be most profitable use."

Real Estate Appraisal Terminology, Edited by Byrl H. Boyce, Ph.D. SRPA, Ballinger Publishing Co., Cambridge, Mass. 1975

- F. The purchase of a piece of real estate today involves the acceptance of a great many assumptions about the future. Those who take care to validate these assumptions in a period of transition as to public land use control tend to have the most successful investment.
  - 1. Business decisions today make explicit recognition of their assumptions and the need to act under conditions of uncertainty.
  - 2. Business risk is the difference between assumptions about the future and realizations, the proforma budget and the end of the year income statement.
  - 3. Risk management is the control of variance between key assumptions and realizations.
  - 4. An appraisal is a set of assumptions about the future productivity of a property under conditions of uncertainty.
  
- G. The concept of highest and best use of land was a commodity concept which did not consider externalities adequately. It is being replaced by concepts of most fitting use and the concept of most probable use.
  - 1. The most fitting use is that use which is the optimal reconciliation of effective consumer demand, the cost of production, and the fiscal and environmental impact on third parties.
  - 2. Reconciliation involves financial impact analysis on "who pays" and "who benefits" - thus the rash of debate on how to do impact studies.

3. The most probable use will be something less than the most fitting use depending on topical constraints imposed by current political factors, the state of real estate technology, and short term solvency pressures on consumer, producer, or public agency.
  4. Most probable use means that an appraisal is first a feasibility study of alternative uses for a site in search of a user, an investor, and in need of public consent.
- H. In seeking the most fitting and most probable use, the inner city planner and private property appraiser must interact to determine how community objectives and consumer - production sector solvency can be achieved simultaneously.
1. A real estate decision has only two basic forms. Either a site is in search of a use and consumer with the ability to pay, or a consumer, need or use with a defined ability to pay is seeking some combination of space-time attributes he can afford.
  2. The individual consumer with needs and a budget is the drive wheel.
  3. The public sector represents the community owned consumer service delivery system, seeking to minimize marginal cost to the consumer and average cost to the community at large.
  4. The production sector responds to a derivative demand for engineering and management expertise.
- I. Critiquing the form and adequacy of a real estate solution is analogous to the artistic concept of judging the success of an art object by relating form of the solution to the context to which it was created.
1. Context includes those elements which are fixed, given, or objectives and to which any solution must adapt.
  2. Form giving elements are those variables within the artists control, i.e. options or alternatives at a particular time.
  3. A solution is judged for its correctness or success in terms of the degree of fit of the form proposed to the context.
  4. Feasibility analysis is concerned with the degree of fit or the extent of misfit between a proposed course of action and the context within which it must operate or fit.
  5. Success therefore depends on how appropriately the problem is defined; testing feasibility depends primarily upon accurate and comprehensive definition of the context.

## II. Market Analysis and Real Estate Feasibility

The space user group or consumer group therefore consists of both a specific customer and a collective group of others who are affected indirectly and who must be "sold" on the compatibility of the project with their more collective interests as well as the specific interest of the ultimate buyer or tenant.

A. The basic mechanisms by which these consumers respond are:

1. The ultimate user responds in the marketplace by means of purchase or boycott.
2. The collective consumer responds through political mechanisms which grant approvals and allocate tax revenue.

B. The general theory of the management process for any enterprise can be converted to real estate semantics for evaluation of feasibility from the viewpoint of individual or collective consumers.

Values, objectives, policy	Strategic format
Search for opportunity alternatives	Market trend analysis
Selection of an opportunity	Merchandising target with monopoly character
Program to capture opportunity	Legal-political constraints
	Ethical-aesthetic constraints
	Physical-technical constraints
	Financial constraints
Construction of program	Project development
Operation of program	Property management
Monitoring and feedback	Real estate research

C. Combining the systems concept of the enterprise process under conditions of uncertainty and the physical concepts of fit leads to a general definition of feasibility:

"A real estate project is "feasible" when the real estate analyst determines that there is a reasonable likelihood of satisfying explicit objectives when a selected course of action is tested for fit to a context of specific constraints and limited resources."

D. More specifically feasibility analysis consists of a sequence of reports, the titles of which reflect the elements of management of an enterprise. Reports can be classified:

1. Strategy study: selection of objectives, tactics, and decision criteria.
2. Market analysis: economic base studies or other related aggregate data review.
3. Merchandising studies: consumer surveys, competitive property analysis, marketability evaluation, etc.
4. Legal studies: opinion on potential legal constraints, miscellaneous contracts or forms of organization, and political briefs.
5. Compatibility studies of project to community planning, conservation standards, or other public policies.
6. Engineering, land planning, and architectural studies.
7. Financial studies: economic modeling, capital budgets, present value and discounted cash flow forecasts, rate of return analysis, financial packages.

### III. Basic Definition of Market and Merchandising Analysis

The critical assumption on which most real estate projects rise or fall are found in the area of market analysis and cost control. This seminar will focus on two aspects of the market research process.

- A. Market data refers to aggregate data, secondary information, sources such as census tracts, employment, family distribution, traffic counts, building permits, and so on.
  1. Such data is useful to scale the size of a marketing opportunity area, as well as the intensity and momentum of the rate of change.
  2. To some degree market data can be processed to predict future patterns of demand and supply.
  3. Absorption rates describe aggregate consumption or levels of market activities in terms of total lots sold over time, total apartments rented, or total square foot leased.
  
- B. Merchandising data is generally primarily information generated by the analyst about specific user groups and specific projects in order to program a marketing effort to divert part of aggregate market demand to a specific project. The elements are :
  1. Definition of a consumer profile
  2. Definition of the competitive product standard.
  3. Discovery of a project competitive edge
  4. Estimate of a capture rate, the ratio of the total aggregate market demand which might be secured for a project or must be secured to achieve financial goals.
  
- C. The fundamental premise for the private real estate developer should be that free enterprise is the art of creating your own monopoly, of exploiting channel demand in order to avoid direct price competition.
  
- D. There is far more aggregate data than is ever relevant to a specific real estate project and therefore in dealing with market data it is useful to use simple logic models to organize the analyst, the report, and the client.
  1. Models explain what you are going to do
  2. Models make relationships and key assumptions explicit
  3. Models permit clients to understand logic of conclusion and to test his own set of assumptions.
  
- E. Identification of monopoly requires careful definition of market segments and this requires a series of disaggregations for market data to merchandising groups. This might be done by geographic clustering, income brackets, marriage status, or common needs such as travelers, industrial users of railroads, etc.
  
- F. A market research model to segment populations, like any model should be carefully reviewed in terms of six basic elements.
  1. What are the questions?
  2. What data is available which is relevant?
  3. What theory is available to focus data on the questions?
  4. How will the results be communicated?
  5. What are the abilities of the analyst?
  6. What is the cost benefit ratio between the model method and the question



#### IV. Seminar Objectives

The use of secondary data for market segmentation as well as survey research for merchandising data are interrelated. However, for purposes of structuring the seminar we have initially subdivided the two topic areas, to bring them back together again on Saturday morning with retail trade analysis.

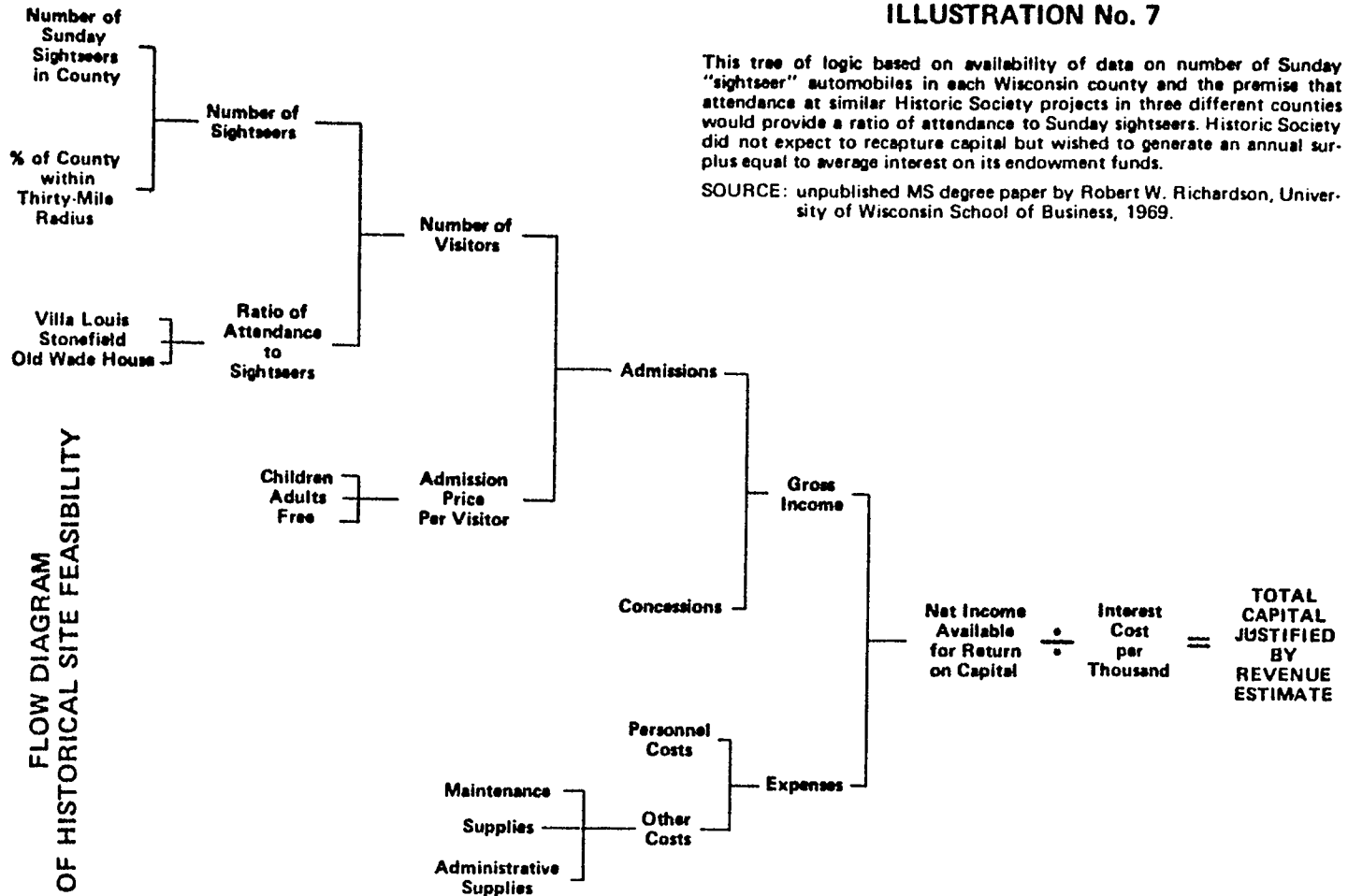
- A. Prof. Craig Stanley will talk about a variety of simple models which might predict community growth, housing demand, retail sales level, and so on, on Thursday.
- B. John Rasmussen will discuss survey research to profile the consumer and competitive projects. Nevertheless, both are necessary for a single project, consider Exhibit #2.
- C. Exhibit #2 is a very simple market model to test the scale of a proposed elderly housing project in the selected county. Project was aimed at those requiring no medical care.
- D. This aggregation process is further illustrated by Exhibit 3. The logic tree or flow chart is always a useful device for outlining a market study and the source of ratios necessary to disaggregate market data to focus on a question.
  1. Each reduction requires some primary source of information
  2. Any given real estate market is always a very narrow subset of a larger collective base. A common area in real estate is to over-estimate the size of that base group or trade area.
- E. While each of the instructors has a primary area of responsibility, we will be generally available to kibitz on each of the topic areas and given the small size of this group we want you to feel free to join in your experience with alternative market methods, survey studies, etc.
- F. As a result of market and merchandising research effort the analyst should be able to construct a marketing program which defines:
  1. The most probable user groups and their effective demand constraints.
  2. The timing of their effective demand in the market.
  3. The competitive standard product minimum.
  4. The competitive product edge necessary for monopoly advantage
  5. Basic elements of a required promotion program.

**EXHIBIT 2**  
**DEMAND FOR ELDERLY RESIDENTIAL CARE UNITS**

Persons in County age 65 and over in 1970		21,914
Adjustment 1970-1974 to reflect the number of persons moving into the 65+ bracket and the application of mortality rates by age and sex		<u>245</u>
Estimated persons in County age 65 and over in 1974		22,159
Less persons 65+ presently in nursing and residential care facilities in County	1,792	
Less persons 65+ presently in government subsidized housing for the elderly	<u>638</u>	<u>2,430</u>
Persons age 65+ in the conventional housing market in County in 1974		19,729
* Estimated number of persons financially qualified for and seriously interested in moving into the proposed residential care development		4,270
Household equivalent (+ 1.519 persons per household)		2,811
* Less estimated number who will not convert serious interest into any form of action (50%)		1,406
* Less the percentage who, while seriously interested, said (before they heard the hypothesis) that their next home would probably be outside County (13.3% from survey questionnaire)		187
* Less those disqualified because their current health status necessitates care beyond the scope of services to be provided in the residential care units (5.4% from survey)	<u>76</u>	<u>263</u>
Elderly households in County qualified for and seriously interested in moving into the proposed development		1,142
* Plus an allowance for those elderly households coming from outside County to enter the proposed development (10%)		<u>127</u>
Elderly households qualified for and seriously interested in moving into the proposed development		1,269
* Share of market opportunity area who stated in survey that for their next dwelling unit their first preference would be an apartment, in a highrise, midrise, or garden building:		
Highrise or midrise	28.0%	
Garden	49.1	
	<u>77.1%</u>	978
Less estimated numbers of households who might move into competitive developments available supply of units		<u>270</u>
Households that can be considered candidates for the proposed development		708
That share of households who said they would be willing to move:		
Within 1 year from now	15.6% - 110 households	
Within 2 years	31.2% - 220 "	
Within 5 years	53.4% - 378 "	
	<u>708</u>	
A project of 100 units requires a capture rate of:		
91% for a 1 - year absorption rate	91% x 100	
(sb. 302) 90% for a 2 year	" " 90% x 330	
(JBD) 14% for a 5 year	" " 14% x 708	

EXHIBIT 3

ILLUSTRATION No. 7



Source: James A. Graaskamp. A Guide to Feasibility Analysis, (Society of Real Estate Appraisers, 1972), p.40.

SKIER MOTEL ROOM DEMAND MODEL

$$P \times R \times T \times D \div PR \times MS = \text{Rooms per Average Weekend Day}$$

where:

P = Total population for counties in the overnight trade area.

R = Skier Participation rate on the average Winter Sunday.

T = For All skiers the average number of overnight skiing trips.

D = Average length (days) of overnight skiing trips.

MS = Market Share (%) of weekend skiers that the Wintergreen motel can capture.

PR = Number of people staying in each room of motel.

Total population for surrounding counties	x .0046	Average Sunday participation rate	x .9	trips per year	1.86	days per trip
÷ three people per room	x 2.5%	conservative market share	= 208	rooms per average week- end day		

# Rent control bill gets mixed reaction

By TOM BURTON  
of the Herald Staff

The rent control ordinance which will be introduced to the Madison City Council Tuesday will probably meet stiff opposition from landlords.

"We're opposed to rent control. It stifles investment incentive, and will result in less available housing," said Bill Smith, executive director of the Madison Apartment Owners Association.

"Rent control when it has been implemented hasn't worked," Smith said. "It will not only hurt building, but will also retard rehabilitation of existing housing."

## City Ready for Controls

But Ald. Ray Davis, Eighth Dist., said he "thinks the city is ready for it." He is one of four alderpersons co-sponsoring the ordinance.

It would create a five-member rent control board appointed by the mayor with the power to make rent adjustments. A landlord would have to apply to the board for a rent increase and be able to justify it at a public hearing. Tenants would have the same power to seek decreases in rent.

UW Residence Halls and owner-occupied houses with less than three rental units or six people would be exempt from the ordinance.

"This ordinance is designed and intended to exert a measure of public control over the rental rates now charged for residential housing in Madison," said Davis.

UW business Prof. James Graaskamp agreed with Smith that rent control would lead to deterioration because it would discourage investment.

"Rent control has always failed, and always will fail. The very people it is designed to help will be destroyed," Graaskamp said.

Davis countered the view that control would lead to decay, since "Rehabilitation of existing housing is a valid reason for landlords to seek rent increases."

New construction would not be influenced by the rent control. The ordinance would exempt all apartments built after its adoption, Davis said.

## Tenants May be Charged

Davis noted that costs of the proposed board would be defrayed by a yearly registration

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**Rent control has always failed, and always will fail. The very people it is designed to help will be destroyed.**

**—UW Prof. James Graaskamp**

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fee to be passed on to the tenants, but that such a fee—about \$3 a year—would not be significant as an increase in rents.

"As a practical man, I can't say rents will go down," said Davis, "but the ordinance will slow down the rate of increase in Madison."

There may be a problem with the constitutionality of the bill, because an opinion by the state attorney general's office said an assembly bill (AB 95) dealing with rent control was "deemed incomplete and constitutionally infirm."

"Probably the only acceptable justification for broad rent control legislation has been a bona

*(Continued on page 2)*

fide emergency," the opinion said.

Davis answered, "It's questionable if it needs to be an emergency. A previous attorney general has held that rent control can be instituted without an emergency."

Davis said there was a "really good chance" of passing the ordinance, but that it definitely will be a close vote.